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ECONOMIC DEFENSE POLICY REVIEW

Staff Study No. 19
Draft of June 15, 1955

Note on the Balance of Payments of the European
Soviet Bloc with the Free World

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Note On The Balance Of Payments Of The European
Soviet Bloc With The Free World

This note is included to explain an apparently contradictory aspect of East-West trade that has frequently been observed. Export surpluses of consistently large value, incurred by the European Soviet bloc in its trade with the free world (especially by the satellites), have appeared in Western trade statistics at the same time that payments problems and bloc indebtedness on clearing account with Western Europe have been increasing. This condition can only be explained by reference to all the items affecting the use of foreign exchange by bloc countries.

Some aspects of this problem are imperfectly understood as a result of incomplete data, but in its major outlines the balance of payments may be described and the unknown elements can be estimated although with less precision than might be desirable. Table 1 contains a summary of the best information and estimates currently available. Further detail on the methods by which these figures were derived is available in EIC-P-5, "The Balance of Payments of the Soviet Bloc with the Free World 1948-1953," ...

In its merchandise trade with the free world, the European bloc has an export surplus only if trade is presented from the standpoint of the free world countries (as it is in their official statistics), that is if bloc exports are valued c.i.f. free world ports and bloc imports f.o.b. free world ports. If bloc exports are presented at their estimated f.o.b.

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value in bloc ports a bloc import surplus appears, which is relatively small in the years since 1949 but quite large in 1948 and 1949.

A further bloc deficit is incurred in the shipping account. Although the actual share of bloc ships and railroads in transporting East-West trade is not known with precision, it is known that the bloc has a limited merchant marine and is undoubtedly a net importer of shipping services. The bloc's deficit on shipping account is estimated at \$25 to \$50 million annually, and the overall balance for trade and shipping shows a bloc deficit of over \$100 million in 1948-49 and \$70-90 million in 1951-1953. In 1954 this deficit almost certainly increased.

From 1948 through 1952, the items included under capital movements and transfers in Table 1 are sufficient to explain foreign exchange acquisitions by the bloc which were large enough to cover all, or most, of the trade and shipping deficits. In 1953, however, such acquisitions had dwindled to insignificance, and in 1954 they were probably no greater. The largest capital transfers, while they lasted, were the Finnish reparations payments and the use of the Swedish credit of 1946-1951, both accruing to the USSR. Private remittances from the US, principally to satellite countries, are a continuing item. Offsetting the above were bloc payments from 1950 to date in compensation for properties of free world owners which had been nationalized by the satellite governments (such payments are, of course, far less than free world claims).

Sales of gold to the free world, mainly by the USSR, account for roughly \$100 million annually in 1949-1952, and rose to \$150 million in 1953. The total for 1954 is about \$125 million. (These figures are

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estimates with perhaps the largest margin of error of any of the figures presented in Table 1.) As capital transfers decreased in 1953 sales of gold increased, but not by as large an amount.

There remain the transfers of foreign exchange holdings, a category which does not have as large an effect on overall payments as the other major categories because the items are smaller and offset one another. It should be noted that Continental Western European balances of the bloc, consisting in large part of clearing accounts, have consistently shown a net increase, i.e., bloc indebtedness has risen, on balance, each year. Bloc holdings of dollar exchange were drawn down sharply in 1948, and were further decreased in later years until 1952 when little more than necessary working balances remained. In 1953 a sizeable quantity of US currency, at least some of which had been acquired through China, was released. Changes in sterling balances and in bloc holdings of Swiss francs were not included in Table 1 owing to a lack of data, and the same is true of some clearing accounts, but it is unlikely that the omitted materials would significantly change the overall payments picture.

When all the above items are added together, a residual of errors and omissions is obtained that shows a net value for bloc foreign exchange earnings the use of which could not be accounted for. In 1948-49 this value was about \$50 million, and in 1950-53 it was \$100 to \$125 million.

There are a number of small omissions which have not been mentioned, and the cumulative errors in all the estimates are potentially large. In view of the direction of the residual values, it is necessary to mention one large omission -- unrecorded trade. Trade may be unrecorded,

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or be wrongly recorded in official statistics, for a variety of reasons and unrecorded trade therefore cannot be identified with clandestine or illegal trade. It is known that the bloc did acquire substantial illegal imports during these years, and this helps to explain the overall balance of known payments items as shown on Table 1. However, the use of the residual item in Table 1 as an estimate of the value of illegal imports should not be attempted in view of the many uncertainties regarding the items from which the residual was derived.

One conclusion which could be drawn from these figures is that the increases in bloc indebtedness on clearing account are not very large in the overall payments picture. But this is only true of the payments of the European bloc as a whole and not of individual countries. The satellite countries, viewed separately, are in a much more restricted foreign exchange position than the USSR, since they have no gold reserves and smaller exportable surpluses and are more dependent on imports. Consequently, they are under pressure to exploit all available sources of foreign exchange including clearing accounts and in some cases private credits.

It might be inferred from this data that bloc countries could solve their payments problems merely by ceasing to engage in illegal trade. But from the bloc standpoint a payments problem arises largely because of the demand for imports from the free world, and those imports which must be acquired illegally -- at higher cost -- are goods on which the bloc places higher, not lower, priority than on goods obtainable through normal commercial channels.

Unquestionably the USSR could help to relieve payments problems of the satellites by transfers to them of its free world foreign exchange

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earnings which could be augmented, if necessary, by increased sales of gold. This may have occurred, although there is no clear evidence of it. The USSR does not extend grants-in-aid, and if it were to transfer free world exchange it would exact some sort of quid pro quo which might be as difficult for satellites to produce as their exports to the West.

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Table 1. BALANCE OF PAYMENTS OF THE EUROPEAN SOVIET BLOC WITH THE FREE WORLD 1948 - 1952
(In millions of US dollars) ^{a/}

	1948	1949	1950	1951	1952	1953
Exports, F.O.B. (Bloc Ports)	1,392	1,302	1,073	1,197	1,095	1,058
Imports, F.O.B. (Free World Ports)	-1,480	-1,449	-1,080	-1,239	-1,145	-1,102
Balance of Trade	-88	-147	-7	-42	-50	-46
Shipping Receipts	51	40	35	50	40	35
Shipping Payments	-88	-78	-64	-93	-67	-61
Balance of Shipping	-37	-38	-29	-43	-27	-26
Balance of Trade and Shipping	-125	-185	-36	-85	-77	-72
Capital Movements and Transfers (Net)						
Finnish Reparations	85	76	34	54	45	40
Swedish Deliveries under 1946 Loan Agreement	11	12	15	29	35	35
Private Remittances from the United States	51	29	15	18	14	17
Czech Drawing on the International Monetary Fund	6	-	-	-	-	-
Compensation Payments for Nationalized Properties	-	-	-	-	-	-
Balance of Capital Movements and Transfers	153	117	48	82	81	51
Changes in Gold and Foreign Exchange Holdings						
Changes in US dollar balances	52	11	6	7	1	1
Changes in Continental European Balances	-46	12	19	18	26	12
Changes in Other Balances	17	b/	17	b/	-10	1
Changes in US Currency Holdings	-	1	-	-	-	10
Sales of Gold	0	100	c/	97	86	147
Net change in Gold and Foreign Exchange Holdings	23	124	105	125	102	171
Errors and Omissions	-51	-56	-117	-122	-106	-104

SIGNS: Minus sign (-) indicates an outflow of funds; no sign, which is in effect a plus sign, indicates source of funds. In the case of gold and foreign exchange holdings, no sign indicates sales of gold by the Bloc, a reduction in foreign assets, or an increase in liabilities to foreign countries; a minus sign indicates the opposite in each case.

a. Data for the most part were converted from original currency units to US dollar equivalents on the basis of rates published by the International Monetary Fund. Where these were not available, rates based on information from the countries involved were used.

b. Argentina had a commercial surplus of \$17 million with Rumania in 1948. This Rumanian debt was repaid by a gold shipment in late 1950.

c. Data on the volume of gold sales in 1949 are tenuous.